COURSE LEARNING OUTCOMES

At the end of this course the students will be able to

CLO 2 Assess the concept of Redemption of shares, debentures, underwriting of shares and underwriter’s liability.

Preview of last class

01

- **Specimen Journal Entries**

- **Model Problems with Solution**

02

Topics Covered

- Redemption of Debenture Meaning
- Conditions
- Debenture Redemption Reserve
- Methods for Redemption of Debentures
- Redemption of Debentures in Lump sum
- Redemption of Debentures in Installments by Draw of lots
- Redemption of Debentures by Purchase from Open Market
- Accounting Entries

REDEMPTION OF DEBENTURES - LECTURE VIDEO

SOURCE

https://www.youtube.com/watch?v=biwqgyVlLzo

CLICK

- by Jagrat Creations, ICWA/CA Foundation

SOURCE - Animation

https://www.youtube.com/watch?v=Qgqalj-9fwM

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Redemption of Debenture - Meaning

- Redemption of Debentures means repayment of the amount of debentures to the debenture holders or discharge of the liability on account of debentures.

- A company is authorized by its Articles of Association and the terms of is sue and redeem the debentures before the due date in prospectus.

Redemption of Debenture - Conditions

The following are the conditions at the time of Redemption of debentures

1. Time:

- Debentures are normally redeemed on the due date. At what time money will be paid back? First one is Lumpsum on a specific date and second one in installments

2. Amount:

- How much money paid. The debentures can be issued at par, premium and discount in the same way debentures can be redeemed at par or a premium but debentures cannot be redeemed at discount.

Redemption of Debenture - Conditions

3. **Mode**:

- How the company will pay by way of Cash through cheque on a due date or by way of kind issuing equity shares of a company on maturity date.

4. **Source**:

- Debentures can be redeemed out of Capital or Profits. If the debentures are redeemed out of capital means no effect on profits. It will reduce cash and liability only. If the debentures are redeemed out of profit means the same amount will be appropriated out of profits of a company

Debenture Redemption Reserve

DEBENTURE REDEMPTION RESERVE

- For Redemption best source is out of profits. There is an Institution called Securities Exchange Board of India.
- This body was exercising and controlling on this point. It has told the company that you have to redeem the debentures only out of profits.
- One more thing that u must keep minimum 50% of amount which u have to redeem in a special account called Debenture Redemption Reserve.

Debenture Redemption Reserve

Where from the DRR is made?

- This DRR is made out of profits. Which profits? the profits available for dividend.
- The Company earns profits it pays taxes, after paying the taxes the profit is available for the dividend.
- The out of the profit is available for t he dividend please transfers 50% of the amount due to be paid to DRR and not use it for any other purpose except redemption.
- This was the direction of SEBI. But w hat the companies are keeping for redemption is 100%. But minimum is 50% it can be more than 50%

Debenture Redemption Reserve

Sub Rule (7): It says all companies will create DRR Excepting 2 companies

1) Banking Companies

2)All India Financial Institutions regulated by RBI

U/s: 21(7) of Companies Act, 2013 – All companies will now create DRR compulsory not less than 25%, SEBI rule is still stand 50%. Minimum 25% of the amount to be redeemed it must be kept in the DRR but more than this up to 100% is allowed.

Debenture Redemption Reserve

DRR in Balance Sheet

- DRR is shown in the Equity and Liabilities part of the Balance Sheet under the head ‘ Share holders’ Funds’ and sub-head ‘Reserves and Surplus’.
- When all the debentures have been redeemed, DRR A/c is closed by transferring the amount to General Reserve.
- The Entry passed is:

Debenture Redemption Reserve A/c Dr.	xxx	
To General Reserve A/c		xxx

Methods of Redemption of Debentures

I) Redemption of Debentures in Lump sum : All the debentures are redeemed on the redemption date specified in the terms of issue, i.e., on maturity at par or at premium.

- **When Debentures are redeemed at par,** Journal Entries are:

On Debentures becoming due for payment:

Debentures A/c Dr. xxx

To Debenture Holders' A/c xxx

(With nominal Value)

On Payment:

Debenture Holders' A/c Dr. (With nominal Value) xxx

To Bank A/c

Methods of Redemption of Debentures

- **When Debentures are redeemed at premium**,

Journal Entries are:

- On Debentures becoming due for payment:

Debentures A/c Dr. xxx
(With nominal Value)
Premium on Redemption of Debentures A/C Dr. xxx
(With the amount of Premium)
To Debenture Holders' A/c (With total)
xxx

On Payment:

Debenture Holders' A/c Dr. (With the amount paid)
xxx
To Bank A/c
xxx

Methods of Redemption of Debentures

- The extra amount paid by the company in the form of premium is a loss to the company, therefore, it is debited by " Loss on Issue of Debentures A/c and credited "Premium on Redemption of Debentures A/c"
- It must be remembered that 'Premium on Redemption of Debentures' is a personal A/c and it is a liability of the company .
- **At the time of redemption, the** Premium on Redemption of Debentures A/c' is debited as the liability is paid.

Methods of Redemption of Debentures

OUT OF CAPITAL

- When debentures are redeemed out of capital the following two Journal entries are passed:
- **On Debentures becoming due for payment:**

Debentures A/c Dr. xxx
(With nominal Value)
Premium on Redemption of Debentures A/C Dr. xxx
(With the amount of Premium)
To Debenture Holders' A/c
xxx
(With total)

On Payment:

Debenture Holders' A/c Dr. xxx
(With the amount paid)
To Bank A/c xxx

Methods of Redemption of Debentures

OUT OF PROFIT

When debentures are redeemed out of Profit the following

Journal entries are passed:

1) On creation of DRR:

P&L A/c Dr. xxx

To DRR A/c xxx

2) On Investment or Fixed Deposit:

Debenture Redemption

Investment A/c Dr. xxx

To Bank A/c xxx

3) **On the amount being due on Debenture Holders, on**

Methods of Redemption of Debentures

b) **If the Debentures are to be Redeemed at Premium**

Debentures A/c Dr. xxx
(With nominal Value)
Premium on Redemption of Debentures A/C Dr. xxx
(With the amount of Premium)
To Debenture Holders' A/c (With total) xxx

4) On enhancing Investment

Bank A/c Dr. xxx
To Debenture Redemption Investment A/c xxx

5) On Payment:

Debenture Holders' A/c Dr. xxx
(With the amount paid)
To Bank A/c
xxx

Methods of Redemption of Debentures

6) Income received and tax have been deducted

Bank A/c	Dr.	xxx	
TDS Collected A/c	Dr.	xxx	
To Interest Earned A/c			xxx

II) Redemption of Debentures in Installments by Draw of lots

- The company can redeem its debentures by payment in each year a part of debentures being selected by draw.
- The holders of the debentures, which are drawn out, are repaid the amount at par or at premium according to the terms of issue.
- DRR is created before commencing redemption of debentures under this method also.

Methods of Redemption of Debentures

III) Redemption of Debentures by Purchase from Open Market

- Like shares, debentures are also transferable from one person to another. Company can discharge the liability in full or part by purchasing its own debentures from the open market provided it18 is authorised to do so by its Articles of Association.
- A company purchases its own debentures when the interest rate on debentures is higher than the market interest rate.
- **DRR:** Before initiating the purchase of debentures for cancellation the company should maintain balance of DRR of an amount at least equal to 25% of the debentures

Methods of Redemption of Debentures

I) When Debentures are purchased in Open Market at price equal to Nominal value of Debentures:

When Debentures are purchased:

Own Debentures A/c	Dr (With purchase cost)	xxx	
To Bank A/c			xxx

For cancellation of Own Debentures:

…..% Debentures A/c	Dr.	xxx	
To Own Debentures A/c			xxx

Methods of Redemption of Debentures

II) When Debentures are purchased at a price below the Nominal Value of Debentures:

a) When Debentures are purchased

Own Debentures A/c Dr. (With purchase cost) xxx

To Bank A/c xxx

b) For cancellation of Own Debentures:

…..% Debentures A/c Dr. (with nominal value) xxx

To Own Debentures A/c (With purchase cost) xxx

To Gain on Cancellation of

Own Debentures A/c xxx

(Excess of face value over cost of own debentures cancelled)

Methods of Redemption of Debentures

Profit on cancellation of Debentures is a Capital Profit and, therefore, it is transferred to Capital Reserve the entry is:

Profit on Cancellation or Redemption of Own Debentures A/c Dr. xxx

To Capital Reserve A/c xxx

Methods of Redemption of Debentures

III) Purchase of own debentures from open market for Investment purpose

i) **On purchase of own Debentures**

Investment in own Debentures A/c Dr. xxx

To Bank A/c (with purchase cost) xxx

ii)Subsequently, the company may decide to:

Resale of own debentures, the entries are passed:

Bank A/c Dr. (Sale price of own debentures) xxx

Loss on sale of Investment in own Debentures A/c Dr. xxx

(Excess of cost over sale price)

To Investment in Own Debentures A/c xxx

(Cost of own Debentures)

To Gain on sale of Investment in own Debentures A/c xxx

Methods of Redemption of Debentures

On transfer of gain on sale of Investment

Gain on Sale of Investment in own Debentures A/c Dr. xxx

To Statement of Profit and Loss A/c xxx

On transfer of loss on sale of Investment

Statement of Profit and Loss A/c Dr. xxx

To Loss on Sale of Investment in own Debentures A/c xxx

Notes:

1) Gain on Sale of Investment in own Debentures is shown under Other Income in the statement of Profit and Loss.

2) Loss on Sale of Investment in own Debentures is shown under Other Expenses in the statement of Profit and loss

Methods of Redemption of Debentures

On Cancellation of Own Debentures:

Debentures A/c Dr. xxx

(with nominal value)

Loss on Cancellation of Own Debentures A/c Dr. xxx

(Excess of Cost Over Face Value)

To Investment in Own Debentures A/c (With Cost)

xxx

To Gain on Cancellation of Own Debentures A/c

xxx

(With Profit)

Notes:

1) Gain on cancellation of own Debentures is profit of capital nature and is transferred to Capital Reserve.
2) Loss on Sale of Investment is shown under Other

Methods of Redemption of Debentures

On transfer of Gain on Can cellation (or Redemption)

Gain on Cancellation of own Debentures A/c Dr. xxx

(with profit on redemption)

To Capital Reserve A/c

xxx

- Treatment of investment in Own Debentures in the Balance Sheet:
- Own debentures purchased for investment purposes are shown at cost in the Assets part of the Balance Sheet under the head 'Current Assets' and sub-head 'Current Investments'

Methods of Redemption of Debentures

Advantages of Redemption by Purchase in the Open Market

1) **Gain on Redemption:** Own debentures are generally purchased at the time when they are trading below par value. The company gains on their redemption, nominal value of debentures being higher than purchase cost.

2) **Reduction in Interest Burden**: company saves on interest payable on debentures held by outsiders.

3) **Saving amount equal to premium payable on redemption:** The company will not be required to pay premium on redemption of debentures in case the terms.

Methods of Redemption of Debentures

Treatment on interest on Own Debentures

- When a company purchases its own debentures and has not cancelled them, interest becomes due on these debentures also.

- The company will debit interest on total debentures, including own debentures held by it.

- However, it will pay interest only on the debentures held by outsiders. Interest on own debentures is retained by the company.

Methods of Redemption of Debentures

When Interest becomes Due on Debentures:

Debentures Interest A/c Dr. xxx
(with total amount of interest)
To Debenture Holders' A/c xxx
(with the amount of interest payable on debentures to outsiders)
To Interest on Own Debentures A/c xxx
(with the amount of interest on debentures held b y company)

On payment of interest on debentures:

Debenture Holders' A/c Dr. xxx
(with the amount paid to outsiders)
To Bank A/c xxx

Methods of Redemption of Debentures

Debenture Interest A/c is shown in

- the Statement of Profit and Loss in the Expense Part under the head 'Finance Costs' and Interest on Own Debentures A/c is shown in the Income Part under the head 'Other Income'.

Test Your Knowledge

LINK

https://forms.gle/82BFC3YGX3jnK1b36

https://docs.google.com/document/d/1Kj-Tla1dbHy383Q3z1gDTFYDGoGcMuiLBKIqnxx4y_M/edit?usp=sharing

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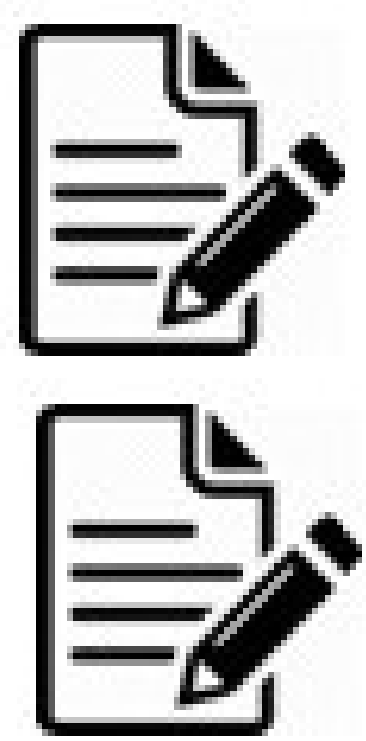

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